

State of Idaho

Legislative Services Office

Individual Entity Audit Report

A communication to the Joint Finance-Appropriations Committee

**IDAHO DEPARTMENT OF
ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND**

FY 2007

**Report OP24707
Date Issued: January 22, 2008**

Serving Idaho's Citizen Legislature

FOREWORD

PURPOSE OF AUDIT REPORT

Our fiscal/compliance audit of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund was made to determine:

1. The adequacy and accuracy of the fiscal records and the reliability of the internal control system in order to issue an opinion on the fairness of the Fund's financial statements.
2. The degree of compliance with various State laws, rules, and regulations affecting the fiscal operations of the Fund.
3. The areas in the financial operations that could be improved.

SCOPE OF AUDIT

We examined the financial operations of the Fund for the fiscal year ended June 30, 2007.

The audit was performed in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards* published by the U.S. Government Accountability Office (GAO).

Information contained in this report was gathered from accounting and administrative records. We also interviewed Department personnel.

AUDIT AUTHORIZATION

Reported to the Joint Finance-Appropriations Committee as directed by the Legislative Council of the Idaho Legislature, authorized by Idaho Code, Section 67-429.

ASSIGNED STAFF

J.E. Bowden, CPA, Auditor-in-Charge
Eric Bjork, Staff Auditor

ADMINISTRATION AND TECHNICAL REVIEW

Don H. Berg, CGFM, Manager, Legislative Audits Division
Chris Farnsworth, CPA, Managing Auditor

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EXECUTIVE SUMMARY LEGISLATIVE AUDITS

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND

PURPOSE AND SCOPE. We have audited the financial statements of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund (CWSRF) for the fiscal year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America. The purpose of our audit is to determine whether the CWSRF's financial statements are materially accurate and reliable, and that the Department complied with laws and regulations affecting fiscal operations. The U.S. Environmental Protection Agency (EPA) requires a separate annual financial and compliance audit of the CWSRF.

CONCLUSION. We conclude that the CWSRF's financial statements are materially accurate and reliable, and fiscal operations materially comply with related laws and regulations. As a result, we issued an unqualified opinion on the CWSRF's financial statements.

FINDINGS AND RECOMMENDATIONS. There are no findings and recommendations in this report or in the prior report.

AGENCY RESPONSE. The Department has reviewed the report and is in general agreement with its contents.

FINANCIAL SUMMARY. The CWSRF is financed by grants from the EPA and State matching funds. The CWSRF is used to provide loans to municipalities at reduced rates to finance construction of publicly owned wastewater pollution control facilities. The financial activity of the CWSRF for the fiscal year ended June 30, 2007 is summarized as follows:

CLEAN WATER STATE REVOLVING FUND - STATEMENT OF NET ASSETS AT JUNE 30, 2007

ASSETS:

Current Assets

Cash	\$21,220,584
Cash - Loan Service Fees	263,902
Investments	43,670,555
Interest Receivable – Fund Balance	245,221
Interest Receivable – Loans	3,115,822
Loans Receivable	<u>3,702,294</u>
Total Current Assets	<u>\$72,218,378</u>

Non-Current Assets

Loans Receivable	<u>\$113,200,860</u>
Total Non-Current Assets	<u>\$113,200,860</u>

TOTAL ASSETS \$185,419,238

LIABILITIES:

Current Liabilities

Payroll Payable	\$7,434
Operating Payable	12,981
Indirect Payable	<u>2,462</u>
Total Current Liabilities	<u>\$22,877</u>

TOTAL LIABILITIES \$22,877

NET ASSETS:

Unrestricted \$185,396,361

TOTAL NET ASSETS \$185,396,361

CLEAN WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2007

<u>Operating Revenues</u>	
Interest Earned – Loans	\$3,875,029
Interest Earned – Loan Fees	6,436
Loan Fees	<u>258,578</u>
Total Operating Revenues	<u>\$4,140,043</u>
<u>Operating Expenses</u>	
Program Administration	
Personnel Costs	\$205,374
Indirect Administrative Expense	65,540
Operating Expense	<u>33,279</u>
Total Operating Expenses	<u>\$304,193</u>
Operating Income	\$3,835,850
<u>Non-Operating Revenues</u>	
Capital Contributions	
Contributions from EPA	4,072,608
Contributions from State	1,141,960
Interest Earned – Fund Balance	
Interest Earned – Idle Pool	1,028,473
Interest Earned – DBF	<u>2,107,073</u>
Total Non-Operating Revenue	<u>\$8,350,114</u>
Changes in Net Assets	\$12,185,964
Net Assets – Beginning of Year	<u>173,210,397</u>
Net Assets – End of Year	<u><u>\$185,396,361</u></u>

OTHER ISSUES. We discussed other matters with the Department which, if addressed, would improve internal control, compliance, and efficiency over the CWSRF.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality, the U.S. Environmental Protection Agency, and the Idaho Legislature and is not intended to be used by anyone other than these specified parties.

We thank the director, Toni Hardesty, and her staff for their assistance and cooperation given to us during this audit.

QUESTIONS CONCERNING THIS AUDIT SHOULD BE DIRECTED TO:

Don H. Berg, CGFM, Manager, Legislative Audits Division
Chris Farnsworth, CPA, Managing Auditor

AGENCY RESPONSE



STATE OF IDAHO
DEPARTMENT OF
ENVIRONMENTAL QUALITY

1410 North Hilton • Boise, Idaho 83706 • (208) 373-0502

C.L. "Butch" Otter, Governor
Toni Hardesty, Director

December 14, 2007

Mr. Don Berg, CGFM, Division Manager
Legislative Audits
954 West Jefferson
Boise, Idaho 83720

Re: Audit Report – 2007 Clean Water Revolving Fund

Dear Mr. Berg:

The Department of Environmental Quality accepts the audit report. We appreciate the hard work of J. E. Bowden and Eric Bjork of your audit staff.

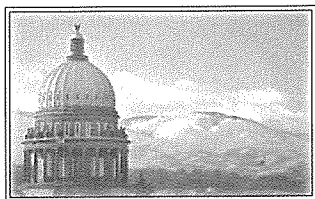
If you or your staff have any further questions, please contact Dave Sande, CPA, Financial Officer.

Sincerely,

A handwritten signature in black ink, appearing to read "Toni", followed by a stylized flourish.

Toni Hardesty
Director

cc: Dave Sande, DEQ-Fiscal Office



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 14, 2007

Unqualified Opinion on
Basic Financial Statements

Independent Auditor's Report

Toni Hardesty, Director
Idaho Department of Environmental Quality
1410 North Hilton Street
Boise, ID 83706

Dear Ms. Hardesty:

We have audited the accompanying financial statements of the governmental activities and the special revenue fund of the Idaho Clean Water State Revolving Fund (CWSRF) as of and for the year ended June 30, 2007, which collectively comprise the CWSRF's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the CWSRF's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the CWSRF as of June 30, 2007, and the respective changes in financial position and its cash flow for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 14, 2007, on our consideration of the CWSRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered when assessing the results of our audit.

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Mike Nugent, Manager
Research & Legislation

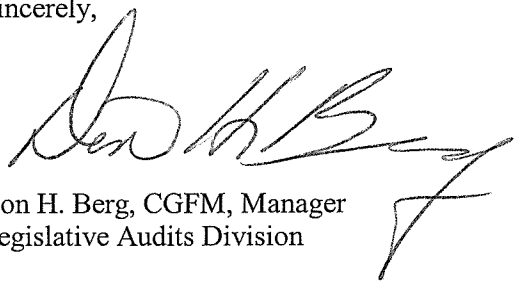
Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

The Management Discussion and Analysis on pages 7 and 8 is not a required part of the basic financial statements, but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion thereon.

Sincerely,

A handwritten signature in dark ink, appearing to read "Don H. Berg". The signature is fluid and cursive, with a large initial "D" and "B".

Don H. Berg, CGFM, Manager
Legislative Audits Division

MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2007

This section of the Idaho Clean Water State Revolving Fund's (CWSRF) annual audit report presents the Department of Environmental Quality's (DEQ) evaluation of the financial performance of the program for the State fiscal year 2007 (July 1, 2006 through June 30, 2007).

OVERVIEW OF FINANCIAL STATEMENTS

The CWSRF's basic financial statements include the Enterprise Fund financial statements and accompanying notes to the financial statements. The Enterprise Fund financial statements consist of the following required elements necessary for fair presentation:

- Statement of Net Assets – This statement presents information on all assets and liabilities of the CWSRF, with the difference between assets and liabilities reported as net assets.
- Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents all revenues, expenses, and changes in net assets of the CWSRF. The information in this statement is segregated into operating revenues, operating expenses, and non-operating revenues.
- Statement of Cash Flows – This statement details the categorical sources and uses of cash within the CWSRF, and provides a reconciliation of income to net cash provided by operating activities.
- Notes to the Financial Statements – This section details the financial activities, accounting policies and practices, as well as specific account information for the CWSRF.

These financial statements provide additional information to the specific operations of the CWSRF than that presented in the State of Idaho fiscal year 2007 *Comprehensive Annual Financial Report (CAFR)*. The Idaho *CAFR* includes the CWSRF; the related but separate Drinking Water State Revolving Loan Fund (DWSRF), which is also operated by the Idaho DEQ; and the Idaho Department of Water Resources' loan program. Taken together, these three programs make up the Loan Fund as reported in the *CAFR*.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR 2007

- The CWSRF made \$16.7 million in loan disbursements to Idaho communities for wastewater projects. The money used for these disbursements was from three primary sources: \$4.1 million from the U.S. Environmental Protection Agency (EPA) CWSRF capitalization grants, \$0.8 million from State matching funds, and \$11.8 million from revolving funds (collected loan repayments and related revenues).
- Loan repayments of \$7.1 million were received, with all loans being current. Historically, the CWSRF has not experienced any loan defaults.
- Investments made by the Office of the Idaho State Treasurer earned \$1.0 million in interest on CWSRF cash deposits remaining in the Idle Pool, and \$2.1 million was earned by the Diversified Bond Fund.

CONDENSED FINANCIAL INFORMATION

	<u>FY 2007</u>	<u>FY 2006</u>
<u>NET ASSETS</u>		
Total Assets	\$185,419,238	\$173,222,581
Total Liabilities	<u>22,877</u>	<u>12,184</u>
Total Net Assets	<u>\$185,396,361</u>	<u>\$173,210,397</u>
<u>CHANGES IN NET ASSETS</u>		
Operating Revenue	\$4,140,043	\$3,403,307
Non-Operating Revenue	<u>8,350,114</u>	<u>9,565,366</u>
Total Revenue	\$12,490,157	\$12,968,673
Operating Expenses	<u>304,193</u>	<u>305,549</u>
Change in Net Assets	<u>\$12,185,964</u>	<u>\$12,663,124</u>

ANALYSIS OF FINANCIAL POSITION

The Idaho CWSRF continued to show growth in fiscal year 2007, as evidenced by the \$12.2 million increase in total assets. This growth in assets was primarily due to the consumption of the federal capitalization grant and the growth of earnings on increasing balances of Loan Receivable and Investments. During fiscal year 2007, EPA grants contributed \$4.1 million toward loan disbursements, while Idaho matching funds contributed an additional \$0.8 million. The CWSRF earned \$3.9 million in loan interest revenue, and cash earned \$1.0 million, and investments earned \$2.1 million.

Loans receivable as of June 30, 2007, was \$116.9 million, an increase of \$12.7 million from the prior year. During the year, the CWSRF made loan disbursements of \$16.7 million, while collecting \$4.6 million in loan principal repayments.

Investments increased \$2.2 million to \$43.7 million due to retainage of earnings. During fiscal year 2007, there were no withdrawals from or additional transfers of cash to investments.

Cash decreased \$3.6 million to a balance of \$21.5 million. This was primarily a result of making loan disbursements of \$16.7 million, of which most were made from revolving funds.

There are no known facts, decisions, or conditions expected to have a significant effect on the CWSRF.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF NET ASSETS
AS OF JUNE 30, 2007

ASSETS

Current Assets

Cash	\$21,220,584
Cash - Loan Service Fees	263,902
Investments	43,670,555
Interest Receivable - Fund Balance	245,221
Interest Receivable - Loans	3,115,822
Loans Receivable	3,702,294
Total Current Assets	<u>\$72,218,378</u>

Non-Current Assets

Loans Receivable	<u>\$113,200,860</u>
Total Non-Current Assets	<u>\$113,200,860</u>

TOTAL ASSETS	<u>\$185,419,238</u>
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LIABILITIES

Current Liabilities

Payroll Payable	\$7,434
Operating Payable	12,981
Indirect Payable	2,462
Total Current Liabilities	<u>\$22,877</u>

TOTAL LIABILITIES	<u>\$22,877</u>
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NET ASSETS

Unrestricted	<u>\$185,396,361</u>
TOTAL NET ASSETS	<u><u>\$185,396,361</u></u>

The accompanying notes are an integral part of these financial statements.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2007

OPERATING REVENUES

Interest Earned - Loans	\$3,875,029
Interest Earned - Loan Fees	6,436
Loan Fees	258,578
Total Operating Revenues	<u>\$4,140,043</u>

OPERATING EXPENSES

Program Administration

Personnel Expense	\$205,374
Indirect Administrative Expense	65,540
Operating Expense	33,279
Total Operating Expenses	<u>\$304,193</u>

Operating Income	\$3,835,850
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NON-OPERATING REVENUES

Capital Contributions

Contributions from EPA	\$4,072,608
Contributions from State	1,141,960
Interest Earned Fund Balance	
Interest Earned - Idle Pool	1,028,473
Interest Earned DBF	2,107,073
Total Non-Operating Revenues	<u>\$8,350,114</u>

Change in Net Assets	\$12,185,964
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Net Assets - Beginning of Year	173,210,397
Net Assets - End of Year	<u>\$185,396,361</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2007**

CASH FLOWS FROM OPERATING ACTIVITIES

Loans and Interest Cash Flows

Cash Received - Loan Interest Payments	\$2,290,163
Cash Received - Loan Principle Repayments	4,576,007
Cash Received - Loan Service Fees	258,578
Cash Received - Loan Service Fees Interest	5,324
Loan Disbursements	(16,712,756)
Subtotal Loan and Interest Cash Flows	<u>(\$9,582,684)</u>

Other Operating Cash Flows

Cash Payments - Administrative Expenses	<u>(\$293,500)</u>
Subtotal Other Operating Cash Flows	<u>(293,500)</u>
Net Cash Used by Operating Activities	<u>(\$9,876,184)</u>

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Cash Received From EPA	\$4,072,608
Cash Received from State	<u>1,141,960</u>
Net Cash Provided by Non-Capital Financing Activities	<u>\$5,214,568</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of Investments	(\$2,110,726)
Cash Received - Interest on Fund Balance	<u>3,163,625</u>
Net Cash Used by Investing Activities	<u>\$1,052,899</u>

Net Decrease in Cash	(\$3,608,717)
Cash Balance - Beginning of Year	<u>25,093,203</u>
Cash Balance - End of Year	<u>\$21,484,486</u>

**Reconciliation of Operating Income to Net Cash
used by Operating Activities**

Operating Income	\$3,835,850
Adjustments to Reconcile Operating Income to Net Cash Used by Operating Activities	
Change in Interest Receivable - Loans	(1,066,624)
Change in Interest Receivable - Loan Service Fees	(1,111)
Change in Loans Receivable	(12,654,992)
Change in Payables	<u>10,693</u>
Total Adjustments	<u>(\$13,712,034)</u>

Net Cash Used by Operating Activities	<u>(\$9,876,184)</u>
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The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE #1

SIGNIFICANT ACCOUNTING POLICIES

Organization of the Fund

The Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Water Quality Act of 1987 (the Act). The Act established the CWSRF program to replace the construction grants program and provide loans at reduced interest rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the CWSRF must be repaid within 20 years, and all repayments, including interest and principal, must be returned to the CWSRF. The money in the CWSRF is to be used for eligible purposes in perpetuity.

The CWSRF is in the process of being capitalized by the U.S. Environmental Protection Agency (EPA) through a series of grants beginning in 1989. States are required to provide an additional 20% of the federal capitalization grant as matching funds in order to receive a grant. As of June 30, 2007, Congress authorized the EPA to award \$118,483,815 in capitalization grants to Idaho. The State is required to contribute \$23,696,763 in matching funds.

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF does not have any full time employees. Instead, DEQ charges the CWSRF for time spent on CWSRF activities by DEQ employees, and the CWSRF reimburses the DEQ fund for such costs. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the CWSRF based on direct salary costs. Employees charging time to the CWSRF are covered by the benefits of the State. The CWSRF is also charged indirect costs of the State through the cost allocation plan for general State expenses.

The financial statements are intended to present the financial position and results of the operations of the CWSRF, a component of the State of Idaho. These statements are not intended to present the financial position or results of operations

for the Idaho Department of Environmental Quality, of which the CWSRF is a part.

Basis of Accounting and Measurement Focus

Enterprise funds, in accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting* are required to apply applicable FASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: *Statements and Interpretations of Financial Accounting Standards Board (FASB)*; *Accounting Principles Board Opinions*; and *Account Research Bulletins of the Committee on Accounting Procedures*. In addition, an enterprise activity may apply all FASB statements and interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements. The CWSRF has elected not to follow FASB pronouncements issued after November 30, 1989.

The CWSRF presents its financial statements as an enterprise fund. Enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting. The State's central accounting system records transactions on a cash basis of accounting. The CWSRF financial records have been converted as necessary to an accrual basis. The accrual basis of accounting requires recording revenues when earned and expenses when incurred.

Operating and Non-Operating Revenue and Expenses

Operating and non-operating revenue and expenses are presented separately on the operating statement. Operating revenue and expenses result from transactions associated with loan disbursements, collections, and the usual activity of the CWSRF (e.g., interest earned and administrative expenses). All other transactions are reported as non-operating revenue, such as contributions from the EPA and the State.

Cash and Cash Equivalents

Pursuant to Idaho Code, all cash of the CWSRF is deposited with the Office of the State Treasurer. The State Treasurer is responsible for the investment of the cash balances of the State.

In accordance with the Clean Water Act and Idaho Code, all cash of the CWSRF is perpetually appropriated for program purposes.

Capital Assets

Capital assets are generally defined as land, land improvements, buildings, fixtures, equipment, and property under construction, and are recorded at cost. The CWSRF owns no land, land

improvements, buildings, fixtures, or property under construction and has no plans to acquire any.

Loans Receivable and Interest Capitalization

Loan funds are disbursed to the local agencies as the agencies incur costs for the purposes of the loan and request loan disbursements from the CWSRF. Typically, interest is calculated from the date that funds are advanced. After final disbursement has been made, the repayment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period. At the loan closing, the loan recipient is given the opportunity to payoff any accrued interest during the construction phase or to capitalize the interest into the loan principal, subject to the available debt capacity of the loan recipient as stated in the loan award.

Management considers all loans to be fully collectible; therefore, no allowance for uncollectible accounts is made.

Indirect Costs – Specific CWSRF Liabilities

Certain liabilities, such as compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases are obligations of the DEQ and the CWSRF receives an allocation of these costs, either through direct expenses as incurred or through the application of a negotiated indirect rate.

For the year ended June 30, 2007, the CWSRF did not have separate specific liabilities for compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases.

State Match

Under Idaho Code, the State match is perpetually appropriated from the Water Pollution Control Account. The State is only required to deposit a cash match into the CWSRF when an actual cash draw from the EPA is made.

Loan Fees

To support the administration of the CWSRF in perpetuity, a loan servicing fee of 1% is assessed on the outstanding balance. The fees are deposited to an account outside the CWSRF and will be used only for administration costs of the program.

NOTE #2

CASH AND INVESTMENTS

The CWSRF participates in the State Treasurer's internal and external investment pools.

The Idle Fund is an internal investment pool managed by the State Treasurer's Office on behalf of participants. Money not

needed to meet immediate operating obligations is invested in accordance with Idaho Code, Sections 67-1210 and 67-1210A. Participation in the pool is involuntary.

Idle Pool Credit Risk

State law limits investments to those listed in the Idaho Code sections identified above. The Treasurer has an informal investment policy to comply with State law, thus limiting credit risk.

The Treasurer's Idle Fund is an unrated internal investment pool. The CWSRF has total deposits of \$21,484,486 in the pool. Deposits are stated at cost, which approximates market.

Idle Pool Interest Rate Risk

The Treasurer has an informal investment policy that limits certain investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

The CWSRF also participates in the Diversified Bond Fund, an external investment pool sponsored by the State Treasurer's Office. A copy of the Idaho *Comprehensive Annual Financial Report (CAFR)*, including the investment pool's financial statement, is available from the Office of the State Controller, Bureau of Reporting and Review.

Idaho Code restricts the State Treasurer to certain types of investments.

Diversified Bond Fund Credit Risk

The State Treasurer's Diversified Bond Fund (DBF) has been assigned a AAA fund credit quality rating and an S2 volatility rating by Standard and Poor's Ratings Service.

The AAA rating of the DBF signifies that according to analysis conducted by Standard and Poor's, the portfolio holdings provide extremely strong protection against losses from credit defaults.

The S2 volatility rating assigned to the DBF indicates the Fund's low to moderate sensitivity to changing market conditions.

Diversified Bond Fund Interest Rate Risk

As of June 30, 2007, the CWSRF investment in the Diversified Bond Fund had a fair value of \$43,670,555 with a weighted average maturity of 3.5 years (from 2006). The State Treasurer has an informal investment policy that limits certain investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

NOTE #3***LOANS RECEIVABLE***Extent, Nature, and Terms of Financial Instruments

The CWSRF makes loans to qualified agencies for projects that meet the eligibility requirements of the Act. Loans are financed by capitalization grants, State match, and revolving funds. Effective interest rates on loans vary between 2.0% and 4.5%, and are generally repaid over 20 years starting within one year after project completion.

Collateral

At the loan closing, the State receives collateral, typically a sewer revenue bond, local improvement district bond or promissory note, from the borrower. As of June 30, 2007, the Office of the State Treasurer held \$41,725,880 (at original face value) of bonds and \$45,980,576 (at original face value) of promissory notes as collateral for the CWSRF.

Loans by Category

Loans receivable at June 30, 2007, are as follows:

	<i>Loan Authorized</i>	<i>Principal Repayments</i>	<i>Remaining Commitment</i>	<i>Receivable Balance</i>
Completed Projects	\$155,620,749	\$86,466,198	\$0	\$69,154,551
Projects in Progress	<u>105,898,026</u>	<u>0</u>	<u>58,169,423</u>	<u>47,728,603</u>
Totals	<u>\$261,518,775</u>	<u>\$86,466,198</u>	<u>\$58,169,423</u>	\$116,883,154
Less: Amount Due Within 1 Year (Current)				<u>3,702,294</u>
Loans Receivable, Net of Current Maturities				<u>\$113,200,860</u>

The projected principal repayments in subsequent years are as follows:

<i>Year Ending June 30:</i>	<i>Amount</i>
2008	\$3,702,294
2009	5,018,059
2010	5,701,739
2011	5,475,859
2012	5,672,635
Thereafter	<u>91,332,568</u>
Total Loans Receivable	<u>\$116,903,154</u>

Major Loans

As of June 30, 2007, the CWSRF had made loans to the agencies listed below that, in aggregate by agency, exceeded \$4 million.

The outstanding balance of these loans represents approximately 80% of the total loan receivable, as follows:

<i>Local Agency</i>	<i>Current Loan Amount</i>	<i>Outstanding Balance</i>
North Lake Sewer and Water District (8)	\$27,187,990	\$20,296,673
City of Pocatello (3)	22,630,315	20,559,353
City of Coeur d'Alene (4)	17,263,961	9,152,896
City of Burley	18,000,000	15,591,331
City of Ammon	15,000,000	0
City of Boise (3)	10,528,098	9,492,167
City of Twin Falls	8,500,000	6,930,759
City of Bellevue (2)	7,150,000	592,643
City of Rigby	7,000,000	235,136
Granite Reeder	6,413,241	163,790
City of Mountain Home	6,000,000	5,019,005
City of Shelley	6,000,000	0
South Fork Coeur d'Alene River Sewer District	5,600,000	4,729,416
City of Rexburg	<u>5,000,000</u>	<u>1,255,928</u>
Totals	<u>\$162,273,605</u>	<u>\$94,019,097</u>

NOTE #4

INTEREST RECEIVABLE

The current loan amount includes projects in construction and projects in the repayment phase. Loans that have been fully repaid are excluded. As of June 30, 2007, principal repayments on completed projects still in the repayment phase were \$15,337,311, and remaining amounts to be disbursed on projects in construction were \$52,917,197.

The interest rate on loans ranges from 2.0% to 4.5%, and loans are generally repaid over 20 years starting within one year after the project is completed. Details of loan interest receivable as of June 30, 2007, are as follows:

Interest Receivable by Category

Completed Projects	\$1,010,759
Projects in Progress	<u>2,105,065</u>
Total Interest Receivable	<u>\$3,115,824</u>

NOTE #5

CONTINGENCIES

The CWSRF is exposed to various risks of loss related to torts, thefts of assets, errors or omissions, injuries to State employees while performing CWSRF business, or acts of God. The CWSRF maintains insurance (through the Idaho State

Department of Administration, Bureau of Risk Management) for all risks of loss. The cost of insurance is included in the indirect costs charged to the CWSRF. There have not been any claims against the CWSRF since its inception in 1989.

NOTE #6

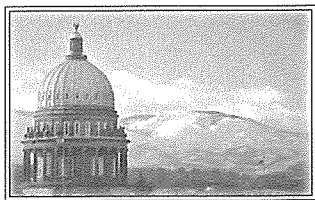
**CONTRIBUTED CAPITAL AND
FUND BALANCE**

The CWSRF is capitalized by EPA grants authorized by Title VI of the Act and matching funds from the State. All funds drawn are recorded as contributed capital from the EPA and the State. As of June 30, 2007, EPA has awarded capitalization grants of \$118,483,815 to the State, of which \$118,287,456 has been drawn for loans and administration of the CWSRF. The State has provided the required matching funds of \$23,696,763. The following schedule summarizes the capitalization grants awarded by federal fiscal year, amounts drawn on each grant as of the balance sheet date, and balances available:

<i>Year</i>	<i>EPA Grant Amount</i>	<i>Total Draws at June 30, 2006</i>	<i>Draws During SFY 2007</i>	<i>Total Draws at June 30, 2007</i>	<i>Balance at June 30, 2007</i>
1989	\$4,577,200	\$4,577,200	\$0	\$4,577,200	\$0
1990	4,738,000	4,738,000	0	4,738,000	0
1991	10,343,215	10,343,215	0	10,343,215	0
1992	9,534,900	9,534,900	0	9,534,900	0
1993	9,431,000	9,431,000	0	9,431,000	0
1994	5,813,800	5,813,800	0	5,813,800	0
1995	6,007,800	6,007,800	0	6,007,800	0
1996	6,318,400	6,318,400	0	6,318,400	0
1997	6,576,800	6,576,800	0	6,576,800	0
1998	6,577,300	6,577,300	0	6,577,300	0
1999	6,577,900	6,577,900	0	6,577,900	0
2000	6,555,200	6,555,200	0	6,555,200	0
2001	6,496,100	6,496,100	0	6,496,100	0
2002	6,510,800	6,510,800	0	6,510,800	0
2003	6,467,800	6,467,800	0	6,467,800	0
2004	6,471,800	6,471,800	0	6,471,800	0
2005	5,243,500	5,216,833	0	5,216,833	26,667
2006	<u>4,242,300</u>	<u>0</u>	<u>4,072,608</u>	<u>4,072,608</u>	<u>169,692</u>
Totals	<u>\$118,483,815</u>	<u>\$114,214,848</u>	<u>\$4,072,608</u>	<u>\$118,287,456</u>	<u>\$196,359</u>

As of June 30, 2006 and 2007, the State match contributions were:

	<i>Total Match Provided at June 30, 2006</i>	<i>State Match Provided in SFY 2007</i>	<i>Total Match Provided at June 30, 2007</i>	<i>Available State Match Balance at June 30, 2007</i>
Idaho CWSRF	\$22,848,303	\$848,460	\$23,696,763	\$0



Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz
Director

December 14, 2007

Independent Auditor's Report on Internal Control
Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial
Statements Performed in Accordance
With Government Auditing Standards

Toni Hardesty, Director
Idaho Department of Environmental Quality
1410 North Hilton Street
Boise, ID 83706

Dear Ms. Hardesty:

We have audited the financial statements of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund's (CWSRF) as of and for the year ended June 30, 2007, and have issued our report thereon dated December 14, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the CWSRF's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Mike Nugent, Manager
Research & Legislation

Cathy Holland-Smith, Manager
Budget & Policy Analysis

Don H. Berg, Manager
Legislative Audits

Glenn Harris, Manager
Information Technology

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Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section, and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

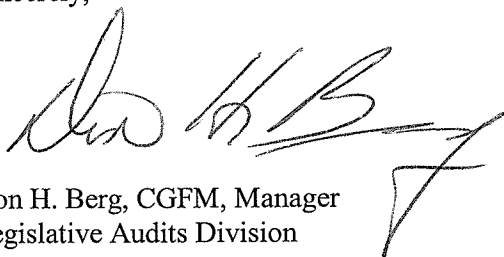
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the CWSRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to the management of the CWSRF in a separate letter.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality and the Idaho Legislature and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Don H. Berg", with a large, stylized flourish extending from the end of the signature.

Don H. Berg, CGFM, Manager
Legislative Audits Division

APPENDIX

HISTORY AND STATUTORY AUTHORITY

The Idaho Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Clean Water Act of 1987. The CWSRF has been capitalized by a series of grants from the U.S. Environmental Protection Agency beginning in 1989.

PURPOSE

The Act established the CWSRF program to provide loans at reduced rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the CWSRF must be repaid within 20 years, and all repayments, including interest and principal, must remain in the CWSRF.

ORGANIZATION AND STAFFING

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF has no full-time employees, but instead uses DEQ employees on a part-time basis. The part-time positions include the CWSRF's bureau chief, senior accountant, loan program specialist, water quality analyst, four regional managers, and several staff and technical engineers.

Department of Environmental Quality
Organizational Structure

